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IN THE

Supreme Court of the United States

TERM, 195 .

No. 457

IN THE MATTER

of

MORRIS R. LEICHTER, Bankrupt

MOSES F. DWORSKY and PHILIP DWORSKY, co-partners doing business as FIDELITY FACTORS,
Objecting Creditors-Petitioners,

vs.

MORRIS R. LEICHTER,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

(Italics ours, unless otherwise noted.)

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Fidelity Factors, a partnership composed of Moses F. Dworsky and Philip Dworsky, by this petition for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit, challenges a determination by that Court on July 7, 1952, which reversed an order of the United States District Court for the District

of New Jersey, affirming an order denying a discharge to Morris R. Leichter, the bankrupt-respondent (R. 100a). The Circuit Court below found the bankrupt guilty of fraud, but granted a discharge nevertheless.

Opinions Below.

The opinion of the Circuit Court of Appeals for the Third Circuit is reported at 197 Fed. (2d) 955.

There was no opinion by the District Judge. The opinion of the Referee, whose order was affirmed on review by the District Court is set forth in the Referee's amended certificate of review (R. 9a-12a).

Jurisdictional Statement.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A. Sec. 347) and Sec. 24(c) of the Bankruptcy Act (11 U. S. C. A. Sec. 47a).

Statutes Involved.

Section 14(c)3 of the Bankruptcy Act reads as follows:

> "The Court shall grant the discharge unless satisfied that the bankrupt has * * * (c) obtained money or property on credit or obtained an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition * * *" (As amended May 27, 1926, c. 406, Sec. 6, 44 Stat. 663; June 22, 1938 c. 575, Sec. 1, 52 Stat. 850).

Statement of the Matter Involved.

The Court below in its opinion (R. 105a) said that the primary question presented by the appeal below was: "Can a bankrupt be denied his discharge in bankruptcy on the mere showing that in his capacity as president of a corporation of which he was a stockholder, he gave a false financial statement, with respect to its corporate assets, which induced a loan to the corporation?"

The facts as disclosed by the record show that Fidelity Factors entered into agreements with Morris R. Leichter, Inc. (a New York corporation), the performance of which was guaranteed by Morris R. Leichter, the bankrupt, individually, under which Fidelity Factors agreed to make advances to the corporation against warehouse receipts for merchandise to be stored in the New York Terminal Warehouse, Inc., a public warehouse (R. 90a-98a), and assignments of accounts receivable (R. 70a-87a).

Petitioner contended below that the bankrupt, directly and indirectly, received the benefit of a false statement and representations made by him with respect to the ownership of the property of Morris R. Leichter, Inc. Obviously, the name Morris R. Leichter, Inc. was obtained from Morris R. Leichter, the bankrupt here. It was established that:

> (a) All the obligations which the bankrupt sought to have discharged in the proceedings below and listed in his schedules arose out of his connection with Morris R. Leichter, Inc. (R. 105).

(b) Morris R. Leichter was the individual with whom Fidelity Factors dealt throughout (R. 19a, 31a, 106).

(c) Morris R. Leichter was the one who directed the general policies of Morris R. Leichter, Inc. (R. 31a, 105).

(4) Morris R. Leichter signed the original agreement between Fidelity Factors and Morris R. Leichter, Inc., dated December 2, 1943 (R. 83a).

(e) Morris R. Leichter signed the agreement between Fidelity Factors and Morris R. Leichter, Inc., dated January 3, 1944 (R. 95a).

(f) Morris R. Leichter furnished to Fidelity Factors a warehouse receipt purporting to show that there were 75 barrels of glaced cherries stored in the New York Terminal Warehouse Company for the account of Fidelity Factors (R. 87a).

(g) Morris R. Leichter furnished to Fidelity Factors a storer's declaration and instructions signed in the corporate name by the firm in his capacity as president (R. 99a).

Fidelity Factors contended below that the only reasonable, normal and logical inference to be drawn from these and other surrounding circumstances, obvious from the record and implicit therein was, that Morris R. Leichter, the individual, and Morris R. Leichter, Inc., were one and the same. One was the alter ego for the other, only an artificial personality separating them. The corporate structure was little more than a naked device for the perpetration of fraud.

The Circuit Court below found as a fact that the allegations of fraud were sustained by the evidence. At P. 107 of the record here, the Court below said:

> "The Referee made the specific finding that the bankrupt in his capacity as president and general manager of a corporation made a false statement as to its assets and obtained credit for it as a result. The record sustains that finding."

Nevertheless, the Circuit Court below reversed the determination of the District Court, (which had upheld the Referee who had denied the bankrupt's discharge) and in substance predicated its reversal upon the lack of proof in the record as to the extent of the bankrupt's stock interest in the corporation. The Court below said (R. 108):

> "Indeed, it is bare of any proof as to the extent of the stockholdings of the bankrupt; there is only testimony to the effect that he was a stockholder—nothing more, nothing less."

This conclusion is without rational basis in the evidence. The bankrupt was *more than merely a stockholder;* he was president, a director and general manager. The Court below concluded that by reason of the absence of proof as to the extent of the bankrupt's stock interest in the corporation, that the decisions in *Levy* v. *Industrial Finance Corporation,* 276 U. S. 281 (1928), relied on by the Referee; *Wilensky* v. *Goodyear Tire & Rubber Co., Inc.,* 67 Fed. (2d) 389 (1st Cir., 1933); and, *In re Licht,* 45 Fed. (2d) 844 (D. C. E. D. N. Y., 1930), were therefore academic and inapplicable.

We contended below, as we do here, that the statement upon which Fidelity Factors relied in extending credit,

to its damage, and which the Courts below have consistently found to have been fraudulent, was in effect the bankrupt's statement, from which he benefitted directly and indirectly, and was sufficient to bring the same within the operation of the statute involved herein.

One other point was considered below, viz.: a specification of objection relating to the bankrupt's books. That point is abandoned in respect to this petition.

Questions Presented.

1. Should a bankrupt be denied his discharge in bankruptcy where it is shown that in his capacity as president of a corporation of which he was a director, stockholder, manager, and exercised dominion and control over its activities, he obtained credit on the strength of a false and fradulent financial statement with respect to its financial condition?

2. Is it an essential ingredient of the liability of a bankrupt who issues a false financial statement with respect to the assets of a corporation, of which he is president, director and manager, that his stockholdings in the borrower corporation be extensive or controlling?

3. Did the Court below set up an arbitrary and artificial standard in construing the statute involved by requiring proof as to the extent of the bankrupt's stock interest in the borrower corporation, where it appears, as here, that he was the dominant and controlling factor in its operations?

4. Did the Court below err in holding upon the proven facts that the false financial statement made by the bankrupt with respect to the corporate borrower did not constitute "his (the bankrupt's) financial condition" so as to bring the same within the language of the statute?

5. Does the ruling below do violence to the spirit and intent of the Bankruptcy Act, which is intended to be for the benefit of honest, insolvent debtors?

Reasons Relied on for Granting the Writ.

1. The final decision in this cause is not limited to the Third Circuit, but is of national effect.

2. The reported cases touching upon the statute involved appear to be in irreconcilable conflict, with resultant confusion, requiring definite clarification by this Court. This Court considered an almost identical problem *In re Applebaum* (C. C. A. 2nd Cir.) 11 Fed. (2d) 685, and it denied certiorari in a memorandum opinion reported at 273 U. S. 712, 71 L. Ed. 853. The decision in *Levy* v. *Industrial Finance Corp.*, 16 Fed. (2d) 769, was in apparent conflict therewith, as a consequence of which this Court granted certiorari (274 U. S. 731, 47 S. Ct. 659, 71 L. Ed. 1327). The *Levy* case, *supra*, involved the construction of Section 14b(3) of the Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 550; June 25, 1910, c. 412, Sec. 6, 36 Stat. 838, 839. The construction given by the Court below to the decision of this Court in *Levy* v. *Industrial* reported at 276 U. S. 281 (1928) and to *Wilensky* v. *Goodyear Tire & Rubber Co. Inc.*, (C. C. A. 1st Cir.), 67 Fed. (2d) 389, appears to be predicated upon the proposition that it is necessary to show that the bankrupt was the holder of all of the stock of the

corporation whose false statement was used as the means for obtaining credit. The Court below set up an artificial and arbitrary standard as to a requisite extent of the bankrupt's stock interest in the corporation which obtained the credit. Nothing in the reported cases establishes the extent of such stock interest necessary to hold a bankrupt liable, sufficient to deny his discharge from bankruptcy. This Court in *Levy* v. *Industrial, supra,* held that it is not possible that the statute should be taken to allow an escape from its words, fairly read, by the simple device of interposing an artificial personality between the bankrupt and the lender. Justice Holmes said, at page 283:

> "We go no farther than the facts before us, and without intimating that our decision would be different, we express no opinion as to how it would be if the bankrupt had no substantial pecuniary interest in the borrower's obtaining the loan."

See also *In re Licht,* 45 Fed. (2d) 844 (D. C. E. D. N. Y., 1930).

3. Clarification of the statute is necessary for the protection of the public at large. Many of the states of the Union do not by their corporate laws require that a director be a stockholder; yet, nevertheless, such directors are individually responsible for their acts in such capacity. The Court below, by its decision, exculpated the bankrupt, who was president, director and a stockholder of the corporation which obtained the credit, by the convenient expedient of holding that the absence of proof of the extent of the bankrupt's stockholdings warranted a discharge from bankruptcy.(*)

(*) The following states do not require that a director be a stockholder: California, Delaware, Florida, Illinois, Maryland, Nevada, New York, Pennsylvania, Virginia.

4. It is essential that Section 14c(3) of the Bankruptcy Act be uniformly interpreted and applied throughout the United States.

5. The contracts between the bankrupt and the objecting creditors are of a type widely used in commercial banking, and, particularly in the accounts receivable financing field. The objecting creditors are actively engaged in that field, as the record discloses. As early as 1941 more than $2,638,000,000 of accounts receivable financing was transacted. *Saulnier & Jacoby, "Accounts Receivable Financing,"* (1943), p. 32, et seq. The impact of the decision below upon such industry is severe, calling for clarification.

ARGUMENT.

POINT I.

(A) The final decision in this cause is not limited to the Third Circuit, but is applicable to other Federal Circuits.

(B) The construction placed upon the statute by the Court below conceivably creates an avenue of escape to culpable bankrupts, contrary to the intent and purpose of the law.

The statute involved, as part of the National Bankruptcy Act, has been the subject of divided opinion, with as many different interpretations of the language and its effect. It is essential for the guidance of all of the Courts of the land that there be a clarification of such doubts as have arisen with respect to the applicability of the statute.

In re Applebaum, supra (1926), dealt with the construction of the word "obtains" appearing in Section 14 of the Act as it then existed, and as to whether the bankrupt got the money or property himself or whether he got it for a third person. The Court found that the corporation got the property, and that although the bankrupt owned all the stock, that there was no evidence that he ignored the corporate entity or treated the corporate till as his own. In discussing the suggested source of the language then before the Court *In re Applebaum, supra,* which the Circuit Court of Appeals for the Second Circuit intimated might have been drawn from the original Statute of False Pretenses (referring presumptively to 30 Geo. (2d) Chap. 24), Justice Holmes, in *Levy* v. *Industrial, supra,* implied that it was equally likely "that they were taken from a more modern source and were used with knowledge of the broader interpretation of later days." This is a clear intimation by this Court that a modern and broad interpretation of the statute should prevail as opposed to a narrow stricture upon the rights of parties affected thereby. *Levy* v. *Industrial, supra,* originally was decided by the Circuit Court of Appeals for the Seventh Circuit, and in view of a conflict between that decision and *In re Applebaum, supra,* this Court granted certiorari. The opinion of this Court is reported at 276 U. S. 281.

In re Licht (U. S. D. C. E. D. N. Y., 1930), *supra,* dealt with specifications of objection charging that the bankrupt obtained money or credit based on a written financial statement of his financial condition, and that he was president and sole stockholder of a corporation known as H. Licht, Inc., which corporation he allegedly used as a cloak or

guise for his own individual transactions. The District Judge discussed *In re Applebaum, supra,* and *Levvy* v. *Industrial, supra,* and said:

> "It will be recalled that in the Levy case the bankrupt was not the exclusive stockholder of the corporation in question, but with his sister-in-law owned more than two-thirds of the stock. The distinction between that condition and the one now under examination seems to be obvious, namely the statement of the condition of the corporation in which Levy was not the only stockholder was not of necessity a statement of 'his financial condition' * * * In the belief that honesty and fair-dealing are equally important, whether the property covered by the statement be held in a corporate guise or by individual title, the exceptions to the specification in question will be overruled."

In *Wilensky* v. *Goodyear Tire & Rubber Co.* ((C. C. A. 1st Cir., 1933), *supra,* the District Court found that the bankrupt conducted a corporation, of which he owned all the stock. He obtained credit for the corporation on the basis of a materially false financial statement, and concluded that the bankrupt had obtained credit for his own benefit. Among the questions on appeal and upon which the decision of the Appellate Court turned in substance was stated by the Court to be as follows: "Did the bankrupt himself obtain credit by making a materially false statement in writing respecting his financial condition?" After discussing *Levy* v. *Industrial, supra,* and *In re Licht, supra,* the Court held that it was clear that the amendment of 1926 did not apply to the facts before it, nor did it control its conclusion. It said, however:

> "Although the amendment in question may be held to tend to 'limit the bars to a discharge,' it clearly does not so limit them as to give a discharge to a bankrupt whose statement as to his financial condition was made under all the conditions which we have stated as an officer of a corporation of which he owned all the stock and which interests are completely bound up. We think the Bankruptcy Act should not be taken to allow an escape from its intent by the device of 'interposing an artificial personality between the bankrupt and the lender.' "

In the case at bar it was shown convincingly and adequately by the record below that the interests of the bankrupt and that of the corporation of which he was president, director, stockholder and manager, were so completely bound up as to make it crystal-clear that the corporation and he were one and the same (R. 19a, 31a, 83a, 87a, 95a, 99a, 105a, 106a).

In *Bernstein* v. *Associates Discount Corp.*, 197 Fed. (2d) 378 (C. C. A. 7th Cir., June 17, 1952), the bankrupt and two others were partners. In order to obtain a loan to the partnership, the bankrupt gave a written statement of his own financial condition which proved to be false. His discharge was objected to and denied. The extent of the interest of the bankrupt in the partnership is not disclosed by the record. We recognize that a partner is liable for partnership debts, but it is a firmly embedded legal principle that a partnership is an entity separate and apart from the partners who compose it. In upholding the denial of the discharge, the Court adopted the philosophy and reasoning of this Court in *Levy* v. *Industrial, supra*, and we contend that the same principles were applicable here with equal force.

POINT II.

No officer of a corporation should be permitted to escape the consequences of his individual wrongdoing by saying that he acted on behalf of a corporation in which he was interested. The decision below being the product of a misconstruction of the statute, nevertheless accomplishes such a result.

We contend that the theory which is properly applicable to the case at bar is that which prevails in the cases where Courts pierce the corporate veil and destroy the fiction of the corporate entity. The Courts have gone so far in an endeavor to do substantial justice as to hold individuals accountable and liable for their acts of wrongdoing, even though they be not stockholders and corporate fiduciaries, where the frauds perpetrated relate to corporate or purported corporate activities.

In *Cohen* v. *Miller*, 5 N. J. S. 451 (1949), a statutory receiver of an insolvent corporation (appointed under a statute judicially adjudged to be tantamount to bankruptcy),* sued for discovery, accounting and a judgment, naming as defendants persons who arrogated to themselves the position of president, secretary, treasurer and manager of the defunct corporation. No corporate meetings had been held; no stock issued; no officers elected; and the persons who undertook to act were self-designated directors. In denying an attack upon the complaint, the Court at page 458 said:

> "They are charged with having organized and used the corporate structure, hollow as it was, as a

(*) *Nutz* v. *Crone*, 109 N. J. E. 98; *Grobholz* v. *Merdel*, 115 N. J. E. 411.

> device for the perpetration of fraud. If so, they are accountable and liable for their acts of wrongdoing, though they be not stockholders or corporate fiduciaries." *Booth* v. *Wenderly*, 36 N. J. L. 250 (Sup. Ct., 1873); *Jennings* v. *Studebaker Sales Corp.*, 112 N. J. L. 399 (E. & A., 1933); *Havey* v. *Hoffman*, 121 N. J. Eq. 523 (Ch., 1937); affirmed, 123 N. J. Eq. 589 (E. & A., 1938); *Cohen* v. *Dwyer*, 133 N. J. Eq. 226 (Ch., 1943); affirmed, 134 N. J. Eq. 350 (E. & A., 1943); *Pennington Trap Rock Co.* v. *Pennington Quarry Co.*, 22 N. J. Misc. 318 (Sup. Ct., 1944).

We submit that the bankrupt's identity with and relationship to Morris R. Leichter, Inc., as disclosed by the record makes it manifest that he was the alter ego of the corporation and that it was in effect a one-man corporation.

In *Hirsch* v. *Phily*, 4 N. J. 408, at 416, VANDERBILT, C. J., in holding that officers of a corporation were personally liable for misappropriation of corporate moneys, although they derived no personal benefit therefrom, said:

> "The underlying reason for this rule is that an officer should not be permitted to escape the consequences of his individual wrong-doing by saying that he acted on behalf of a corporation in which he was interested." 3 Fletcher on Corporations, Secs. 1140-1142; *Rose* v. *Bernhardt*, 107 N. J. L. 501, 504 (E. & A., 1931); *Reliable Woodworking Co.* v. *Lindeman*, 105 N. J. L. 121.

In view of the showing that there are many states of the Union which do not require a director or officer to be a stockholder, we contend that the decision below opens a wide avenue to commercial offenders to perpetrate frauds

in corporate guise and to make it possible for them to escape the consequences of their acts. This, we respectfully submit, should not be permitted to happen.

Conclusion.

The petition for the writ of certiorari should be granted.

Respectfully submitted,

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